

Q4

FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 4, 2019

bigvoice
Making change happen

 @fsb_policy

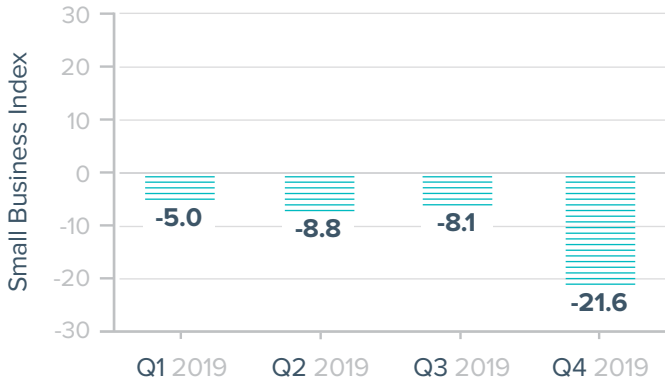
fsb.org.uk

fsb⁰³
Experts in Business

SBI Q4 2019

“Small business confidence at lowest point since last recession”

Long-term optimism slump continues

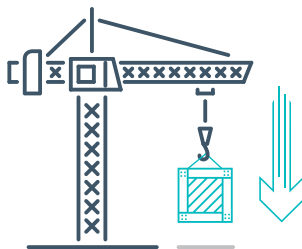


Profitability at five-year low



42% report a **decrease** in **profits**

Exporter optimism in short supply

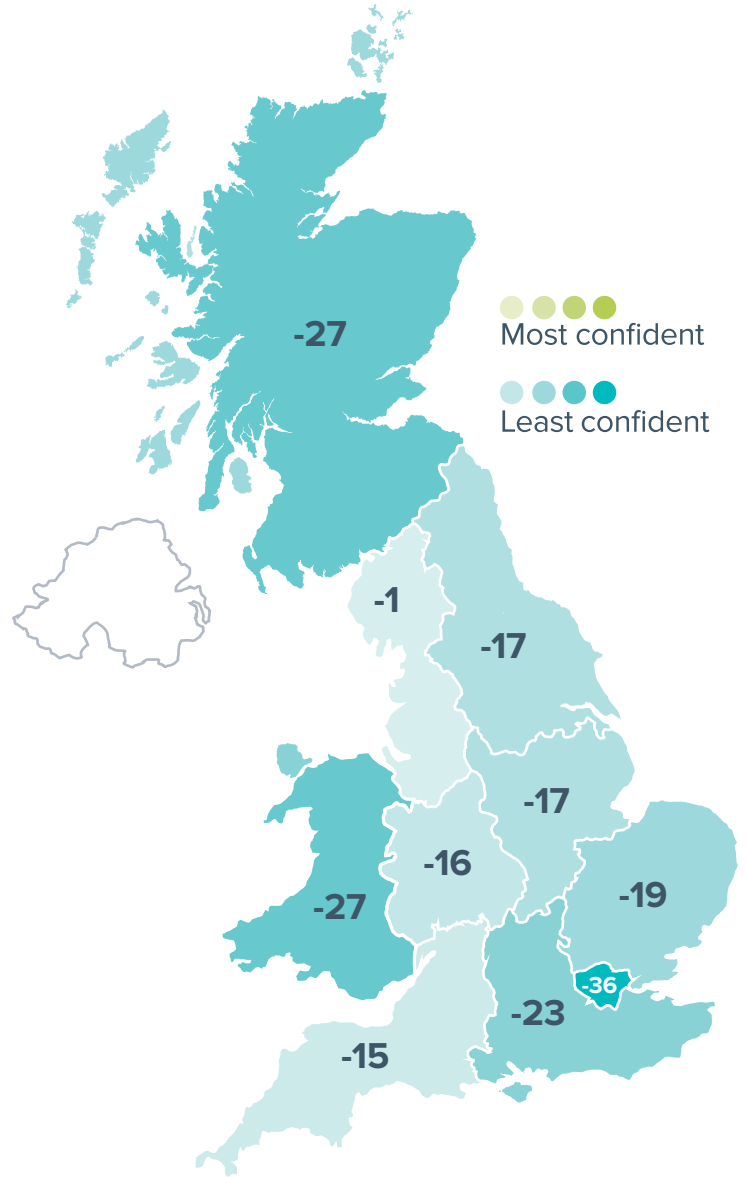


23% expect **international sales** to **increase** next quarter

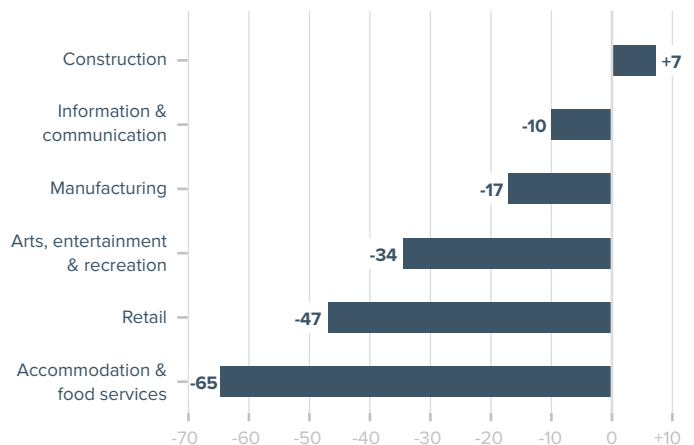
Skills shortages an increasing barrier to growth



37% report **problems** finding appropriately **skilled staff**



Small business confidence by sector



CONTENTS

FSB Foreword 4

Economist’s view 5

FSB executive summary 6

UK macroeconomic overview 7

Small business index. 9

Regional small business indices 11

Small business sector indices. 13

Financial performance 15

Exports 17

Costs and inflation 19

Capacity. 22

Employment. 24

Growth aspirations and challenges. 27

Credit 30

Investment and productivity. 34

Methodology 36

FSB FOREWORD

Ahead of the outcome of the 2019 general election, small business confidence was deep in negative territory, and at its lowest ebb for eight years. The political and economic uncertainty surrounding the Brexit process had clearly taken its toll. The impact of this uncertainty on small business behaviour has been stark, with both hiring and capital investment taking a hit.

The cost of labour has remained the most common source of rising outgoings for small firms. With regards to capital investment, comparing Q4 2019 with Q4 2018, year-on-year capital investment has fallen as economic and political uncertainty remained throughout last year.

It is important that the upcoming Budget on 11 March is used to bolster small business sentiment through tackling the ever-increasing costs of doing business. We need to see the Government commit to delivering its manifesto promise to increase the Employment Allowance from £3,000 to £4,000, thus reducing the cost of National Insurance contributions to many small employers.

FSB welcomes the confirmation from the Government of its plans to increase the business rates small business retail discount from 33% to 50%, to broaden its scope beyond retail, and to add extra support for local pubs. The Government has promised a proper review of business rates with a single aim of reducing the burden, and that review must be launched soon. As our evidence shows, confidence in consumer-facing industries has collapsed.

The challenges faced by smaller businesses on the high street are acute, and we need to see a clear, holistic strategy to support these firms. Many separate pots of funding have been announced – including the High Streets Fund and the Stronger Towns Fund – but more needs to be done to support the small businesses that can be a leading force in the transformation of high streets.

Although early indications are that confidence has rebounded since the decisive election result, uncertainty remains about the nature of the deal that will be struck with the EU now we have left the bloc.

We await the publication of the UK's negotiating objectives. Nonetheless, it is clear from the Government's actions that there is no intention to extend the transition period, and the nature of the trade deal we strike with the EU will be based on a free trade agreement approach. This means that, whatever deal is struck, smaller businesses will see some additional friction in their trade with the EU.

They will also be able to benefit from potential future trade agreements with nations across the globe. It is essential that smaller exporters and importers receive sufficient time and financial support to make the adjustments to benefit from new FTAs. Our data show that the net balance of firms expecting to increase the value of their exports in the next quarter fell by 5.4 percentage points during Q4 to -9.5. This is the lowest level on record.

Finally, in relation to skills, FSB data confirms a consistent theme – namely that skills shortages are impacting small business growth.

In Q4 of 2019, more than a third of small businesses report that finding skilled staff is a barrier to expansion – this proportion has never been higher since we started recording this metric.

The Migration Advisory Committee (MAC) recently announced its response to the Government's request to assess how to implement an Australian Points-Based System in the UK and the level at which the salary threshold for those looking to make the UK their home should be set.

FSB has welcomed the MAC's recommendation to reduce the originally proposed £30,000 salary as an important starting point.

Whilst we are committed to boosting adult retraining and have championed the rebirth of technical education as a public policy priority, we also recognise it will take many years for these reforms to take effect.

Therefore, small businesses need a new immigration system that enables them to access the skills and labour they need from across the globe. A sudden drop in the supply of EU labour – at all skill levels on 1 January 2021 – will have a disproportionate impact on smaller businesses and damage the UK economy.

Alongside visas requiring a job offer, we need to see a temporary non-sponsored route made available for EU/EEA nationals for a stay of two years to give smaller businesses the time they need to adjust – whether that is in relation to adopting new forms of technology and automation, or retraining their staff.

For those smaller businesses seeking to use the employer-sponsored visa routes, it is vital that costs are kept to a minimum and the system is easy to use and efficient. The new system must support the Government's ambitions to level-up the UK: ensuring no region or nation is left behind, as well as guaranteeing that critical sectors such as social care and construction are not damaged.



Mike Cherry,
National Chairman



Martin McTague,
Chairman,
Policy and Advocacy

ECONOMIST'S VIEW

The end of Q4 2019 saw the UK beginning to emerge from a three-year parliamentary deadlock. Regardless of one's opinion about the decisive general election result, it is important to acknowledge that the degree of uncertainty, especially in regard to the Brexit trajectory, has been reduced. This will go some way to supporting business investment and consumer confidence in the coming months. However, as the election only took place in mid-December, much of the data in the Q4 FSB Small Business Index (SBI) reflects the pre-election period. October, November and the first half of December were marked by expected pre-election uncertainty and a stream of weakening economic data. This is reflected in the SBI reading, which hit an eight-year low of -21.6.

The index readings in the final quarter of 2019 were bleak across the nation. Every one of the UK's constituent regions and nations recorded declining confidence between Q3 and Q4 2019. Yorkshire and the North East and London recorded the largest quarter-on-quarter declines in small business sentiment. This means that London is now the least confident region in the UK.

With the Conservative Party realising electoral gains in various northern areas, we are expecting additional spending commitments aimed at boosting growth in economically underperforming regions. This may mean an improvement in SBI readings across regions that have not performed especially well in the past.

In terms of the sectoral picture, the fall in confidence was least drastic (just 0.1 points) among construction firms.

Small businesses in consumer-focussed industries fared much worse. Confidence in the wholesale & retail trade and accommodation & food services sectors declined by 22.2 points and 33.0 points respectively. Consumer confidence began to recover post-election and, paired with persistent wage growth and low unemployment, will hopefully support businesses in these areas in the New Year.

Cebr expects 2020 to be a year of decent economic growth in the UK. The expansion will be supported by a variety of factors including a recovery in consumer confidence, return to stronger business investment growth, government spending pledges and accommodative monetary policy. The UK's political and economic environments are quite different now compared to much of the period that this SBI recovers. With this in mind, it will be interesting to contrast these findings with those that will be published in Q1 2020.



Nina Skero,
Director and Head
of Macroeconomics,
Cebr

Q3

FSB EXECUTIVE SUMMARY

Key findings this quarter:

- **In Q4 2019 small business confidence** dropped to an eight-year low. The FSB Small Business Index now stands at -21.6 following a decline of 13.5 points from the previous quarter. The index has now been stuck below zero since Q3 2018.
- **The level of confidence among small businesses fell in every one of the UK's constituent regions and nations in Q4.** Yorkshire and the North East recorded the largest quarter-on-quarter decline in small business sentiment, falling 31.2 points to -17.1.
- **Consumer-focussed industries suffered rapidly declining confidence during the final quarter of 2019.** Accommodation & food services became the least confident sector after a quarterly fall of 33.0 points to stand at -65.0.
- **The net balance of firms expecting to increase the value of their exports in the next quarter fell by 5.4 percentage points during Q4 to -9.5.** This is the lowest level on record, and is only the third time that the export growth expectations net balance has been negative.
- **Labour was cited as a cause of rising costs by 43.5% of small businesses in Q4 2019.** This was a quarterly increase of 3.6 percentage points and means labour is still the most common source of rising cost pressure for small firms. In the accommodation & food services sector two thirds (65.6%) of businesses are flagging labour costs as an issue.
- **Finding appropriately skilled staff was a barrier to growth for 37.2% of small businesses in Q4 2019.** Since this category was included in the survey in Q4 2013, the proportion of businesses reporting concern over their ability to recruit staff with the right skills has never been higher.
- **Compared to the previous quarter, the employment net balance fell by 3.4 percentage points to -1.5% in Q4 as a higher proportion of small businesses reduced their employment levels rather than increased them.** Almost one-in-four (24.0%) small businesses in Wales indicated a reduction in staff numbers during the final quarter of 2019.

UK MACROECONOMIC OVERVIEW

UK services growth slows as manufacturing recession drags on

Growth in the UK economy was volatile during 2019 as the ever-changing deadlines and aims of the Brexit negotiations left businesses and households uncertain about the future. This uncertainty over the future made funding new equipment and machinery riskier, and business investment fell every quarter throughout 2018. Although investment rose again at the start of 2019, it has now flatlined, and total investment over the four quarters to September 2019 was around 2% down on the peak recorded in Q2 2018. Consumers are also apparently reducing their risk appetite - consumer credit grew by just £0.6 billion in November 2019, which is the smallest increase since November 2013.

The desire to reduce exposure to risk has driven a number of major macroeconomic trends during the last few years. Notably output spiked in the first quarter of 2019, particularly among industries that are reliant on imported parts. The risk of the UK crashing out of the EU without any trade deal meant large inventories of inputs and finished outputs were built up in case supply chains were disrupted. This would have allowed businesses to continue operating through the worst effects of a sudden, chaotic no-deal Brexit. As the initial deadline was extended to October, these inventories were deemed excessive and stock sold-off, causing output to fall.

The rolling three-month growth rate of the manufacturing sector, which had been falling in the final quarter of 2018, reached 2.4% in March 2019. Except for the three months to September, manufacturing output has fallen in every three-month period since May. The impact of the domestic uncertainty is exacerbated by slower global growth. Industrial production across both the eurozone and the UK is also suffering due to weakness in a number of export markets worldwide.

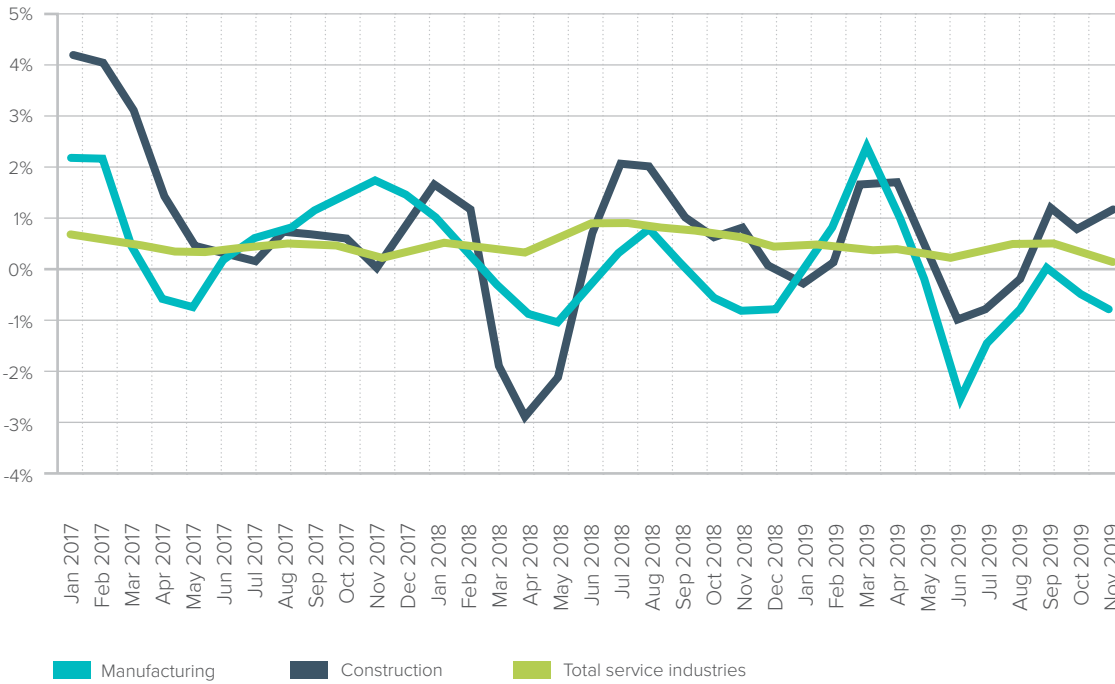
However, the UK labour market has largely defied the slowdown. In the three months to November, the UK's employment rate rose to 76.3%, the highest estimate on record. Meanwhile, the unemployment rate remained at 3.8% – the lowest rate since the final quarter of 1974 and 0.3 percentage points lower than the same period a year earlier. As the labour market strengthened, annual growth in average weekly earnings (including bonuses) peaked in the three months to July 2019, at 3.9%.

The data for the third and fourth quarters of 2019 indicate signs of slack have started to emerge in the labour market. Vacancies have fallen by 49,000 in the three-months to December compared to the same period a year earlier. This was down by 11,000 on the previous quarter. The combination of slower wage growth and muted hiring expectations suggest that the labour market's shine seems to be fading.

The debilitating uncertainty of the last year was in no small part generated by a fractious and deeply divided Parliament. This issue has now been firmly resolved by the result of the December general election. Even so, the hard work of finalising a long-term trade deal with the EU that will take effect after the Brexit transition period ends in December 2020

is only just beginning. The question marks over what lies ahead may still present too large a risk for some businesses and households to begin investing and spending in larger numbers. Nevertheless, a narrowing of potential risks should allow for the release of some pent-up demand, which will help the economy to perk up in 2020.

Figure one: Monthly growth rates by sector of the UK economy, latest three months on previous three months
Source: Office for National Statistics.



SMALL BUSINESS INDEX

The Small Business Index hits an eight-year low

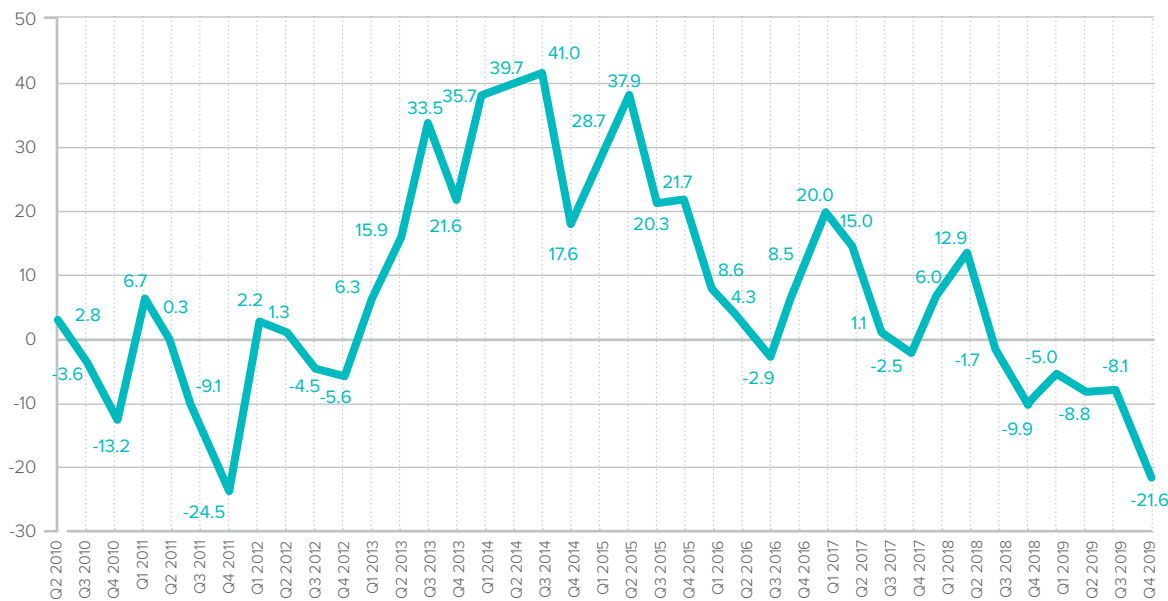
Business confidence among small firms plummeted to the lowest level since Q4 2011 in Q4 2019. The FSB Small Business Index sits at -21.6, a decline of 13.5 points from the previous quarter. Year-on-year, the index fell by 11.7 points meaning the index has recorded nine consecutive quarters of annual declines. Notably, the index has now been below zero since Q3 2018.

Most survey data supported this negative outlook for UK businesses, with the UK Purchasing Managers' Indices (PMI) recording negative sentiment in both construction and manufacturing in December. At 47.5, the manufacturing PMI was at its second-lowest level for more than seven years, and has been negative (i.e. below the no-change mark of 50.0) for eight consecutive months. The construction PMI also registered an eighth consecutive month below the 50.0 mark, reaching just 44.4 following a fall of 0.9 points in December.

The services sector was an anomaly in that the PMI improved in December, but at just 50.0 this indicated that going into 2020 businesses covering 80% of the UK economy were anticipating little if any growth in output.

The weakness in business survey data coincides with weakness in official data on economic growth. The descent of the Small Business Index into negative territory appeared out of line with actual economic output during Q1 2019, when growth spiked. This was driven by short-term stockpiling that has since given way to stagnation with year-on-year growth in GDP falling to just 1.0% by Q3. The latest decline in the index during Q4 indicates that a further deceleration in growth is on the cards unless the strong parliamentary majority produced by the general election, and associated clarity over Brexit and other areas of economic policy is sufficient to stimulate higher business confidence and investment.

Figure two: The FSB Small Business Index¹: small business prospects over coming three months
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



1. The Small Business Index is a weighted index of the responses to the question: 'Considering your overall business performance, and ignoring any normal seasonal variations at this time of the year, how do you view business prospects over the next three months, compared with the previous three months?' The share of firms reporting 'much improved' are given the following weightings: +2, slightly improved +1, approximately the same 0, slightly worse -1 and much worse -2; the Small Business Index is derived from the sum of these factors.

Figure three: Year-on-year change in the FSB Small Business Index.
 Source: FSB - Verve 'Voice of Small Business' Panel Survey.

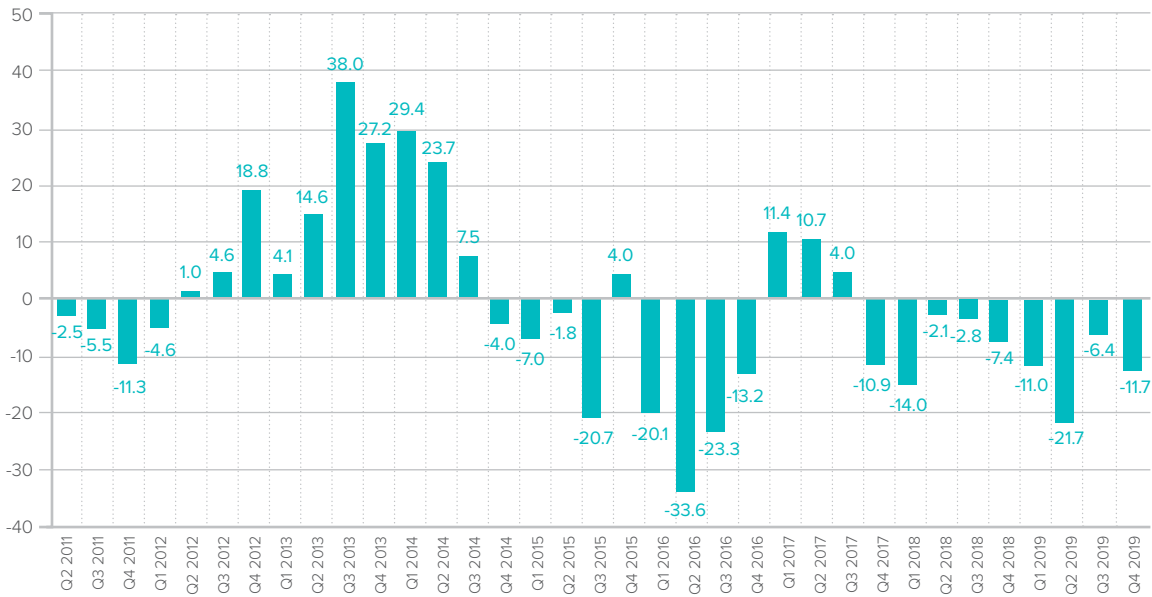
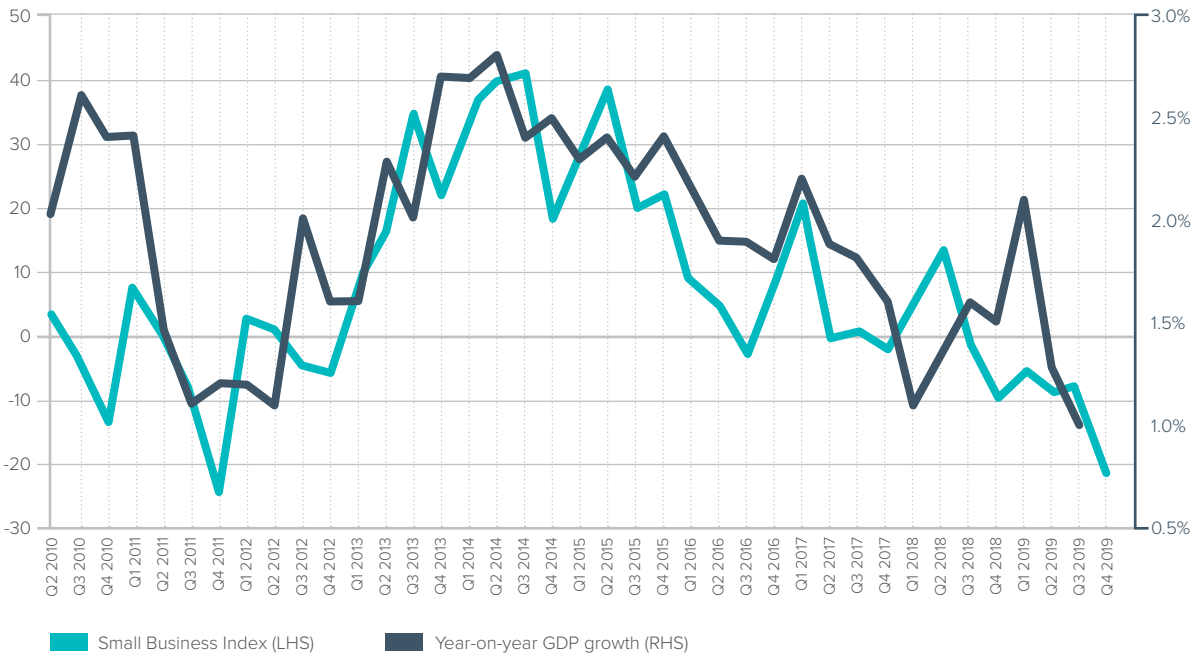


Figure four: UK SBI against year-on-year UK GDP growth.
 Source: ONS, FSB - Verve 'Voice of Small Business' Panel Survey.



REGIONAL SMALL BUSINESS INDICES

A bleak picture UK-wide

SMALL BUSINESS CONFIDENCE FALLS ACROSS ALL REGIONS AND NATIONS

Every one of the UK's constituent regions and nations recorded declining small business confidence between Q3 and Q4 2019. Yorkshire and the North East recorded the largest quarter-on-quarter decline in small business sentiment in Q4 2019, falling by 31.2 points to -17.1. The second-largest decline in confidence among small businesses during the final quarter of 2019 was seen in London. After a fall of 25.9 points, small business confidence in the capital stood at -36.4, meaning those based in London are the least confident in the UK.

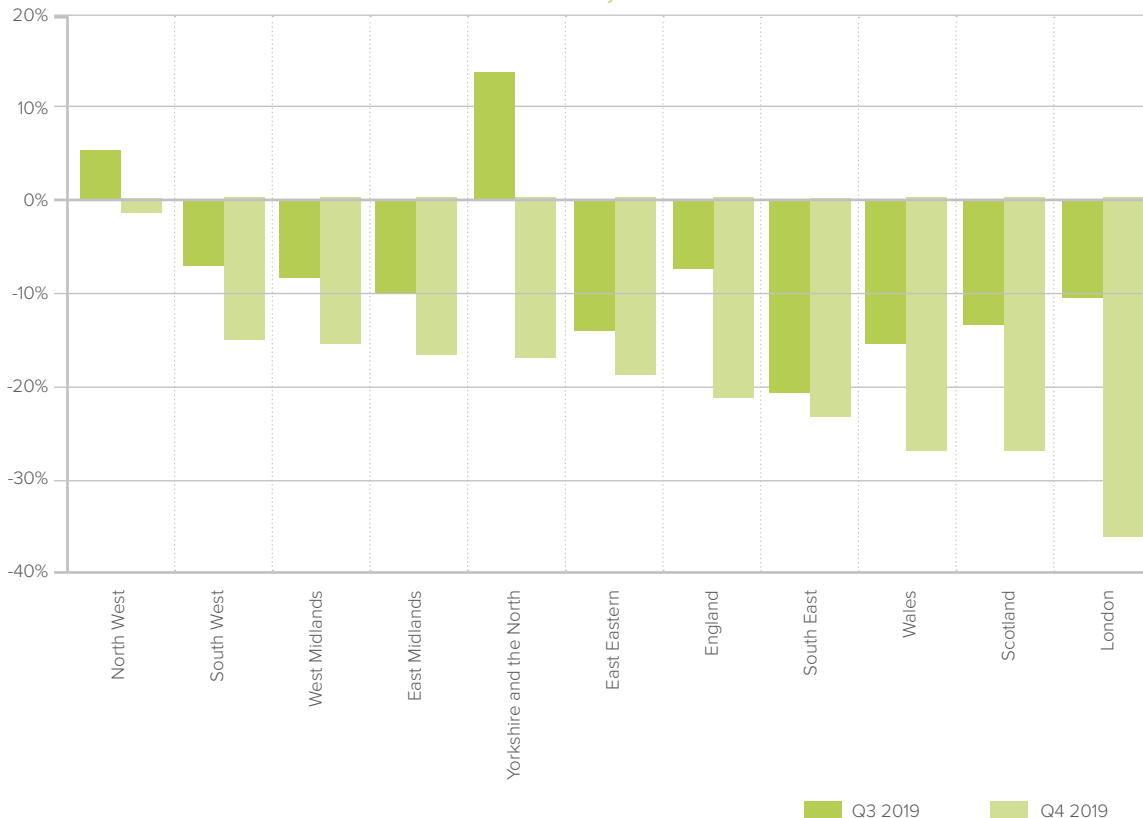
Despite falling by 6.8 points, from 5.5 in the third quarter, small business confidence was highest in the North West, standing at -1.3 in Q4. Moreover, confidence in the North West is up by 14.3 points compared to Q4 2018. While Scotland was low on confidence in Q4 (-27.2), its small business index showed a year-on-year increase of 5.5 points from the -32.7 recorded in Q4 2018. Although a longstanding period of uncertainty has left the wider UK economy stagnating, and small business confidence is universally negative, improved confidence in some

regions compared to Q4 2018 suggests that the biggest downsides to these regions may now have been avoided causing optimism to rise compared to last year.

The general election brought a renewed focus on rebalancing government priorities away from London and the South East. Businesses based in the North West may feel well-placed to benefit from this change in approach for instance with new infrastructure spending now more likely. Furthermore, the prospect of Brexit ending with a goods-only trade deal became apparent with the election of a Conservative majority government. This would maintain better EU market access for businesses in the UK's manufacturing heartlands than for more service-based economies in the South East. A Conservative government with a significant majority in Parliament also looks set to deny any further move towards Scottish independence. Avoiding another source of uncertainty may have helped lift small business sentiment in Scotland compared to last year.

Figure five: FSB Small Business Index – regional variation in small business prospects over coming three months

Source: FSB - Verve 'Voice of Small Business' Panel Survey.



SMALL BUSINESS SECTOR INDICES

High streets feel the pinch

SMALL BUSINESS CONFIDENCE COLLAPSES AMONG CONSUMER-FACING INDUSTRIES

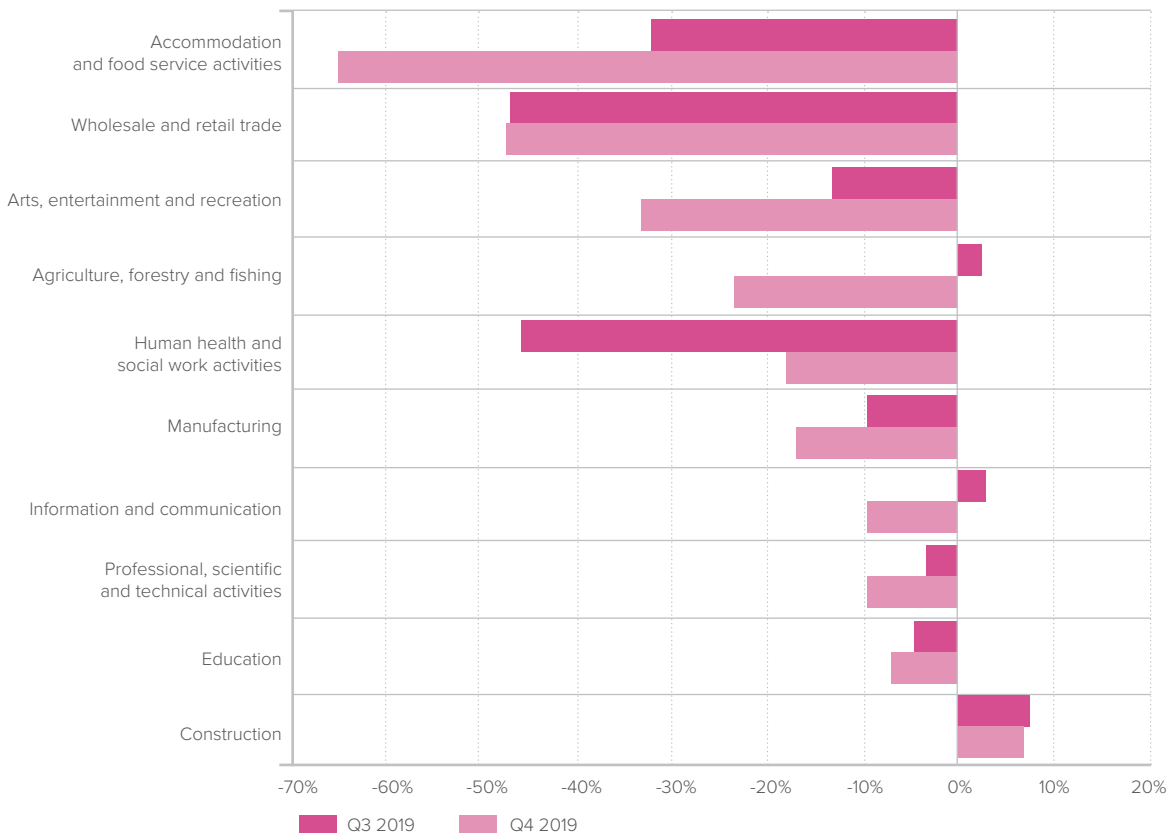
Confidence fell among small businesses across all major sectors of the UK economy during the final quarter of 2019. The fall in confidence was mildest among small construction businesses, a decline of 0.1 points between Q3 and Q4 left the sector's small business index standing at +7.2. The latest official estimates of GDP growth show that output in the construction sector expanded by 1.1% in the three months to November 2019, compared to the previous three-month period. With no-deal Brexit apparently off the table and a strong majority for the new government in Parliament, construction firms may soon benefit from more secure funding for infrastructure projects.

In the three months to November, growth in the UK's professional, scientific and technical services sectors slowed to 0.2%, down from a recent peak of 1.5% in the three months to August. Confidence among small businesses in the sector fell by 6.4 points between Q3 and Q4 to stand at 9.6%. Small businesses in the information and communication sector were close

behind, with confidence standing at -10.2 in Q4 following a quarterly decline of 13.1 points. However, despite being squarely in negative territory, both sectors were more confident than the UK average (-21.6).

Smaller businesses in consumer-focussed industries fared badly during the final quarter of 2019. Confidence in the wholesale & retail trade and accommodation & food services sectors declined by 22.2 points and 33.0 points respectively. This meant accommodation & food services businesses (-65.0) were the least confident in Q4 2019. Meanwhile, wholesale & retail trade sector confidence was also well below average, standing at -47.5. Despite decent rates of real wage growth, falling confidence throughout most of 2019 led consumers to hold back on borrowing and postpone larger purchases. In addition to lower demand, labour costs have risen considerably for consumer-facing industries as the national minimum wage increased well above the rate of inflation in April 2019.

Figure six: FSB Small Business Index by sector – small business prospects over coming three months. Source: FSB - Verve 'Voice of Small Business' Panel Survey.



FINANCIAL PERFORMANCE

Margins squeezed
amid uncertainty

PROFITABILITY HITS LOWEST POINT SINCE Q1 2013

The net balance of small businesses reporting growth in profits fell to -14.4% in Q4 2019. Across the UK, 41.7% of small businesses reported a decrease in profit over the quarter compared to just 27.3% reporting an increase. This marked a fall in the net balance of 3.0 percentage points since Q2 2019 when this question was last asked. The gross profits balance is now at its lowest level since Q1 2013 and more small businesses have reported falling profits than have reported rising profits consistently since Q1 2016.

The net balance was lowest in the West Midlands (-31.9%), where more than half (50.6%) of small businesses had seen their gross profits fall during the last quarter. With every region and nation in

the UK reporting a net balance of businesses with falling gross profits, it is unsurprising that business confidence has fallen deep into negative territory in Q4 2019. Businesses in the accommodation & food services sector recorded the lowest levels of profitability in Q4. Just 4.4% of businesses saw an increase in profits, compared to nearly two-thirds (64.1%) which saw a decrease, leaving a net balance of -59.7%.

Over the next three months the net balance of smaller businesses expecting their profits to improve is -14.0%. This suggests very few small businesses see an improvement in trading conditions on the cards as they head into 2020. This is the lowest net balance for profit expectations since Q1 2013.

Figure seven: Small business gross profits, net percentage balance – proportion reporting/ expecting increase less proportion reporting/ expecting decrease.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



EXPORTS

International sales slump

EXPORT EXPECTATIONS HIT RECORD LOW

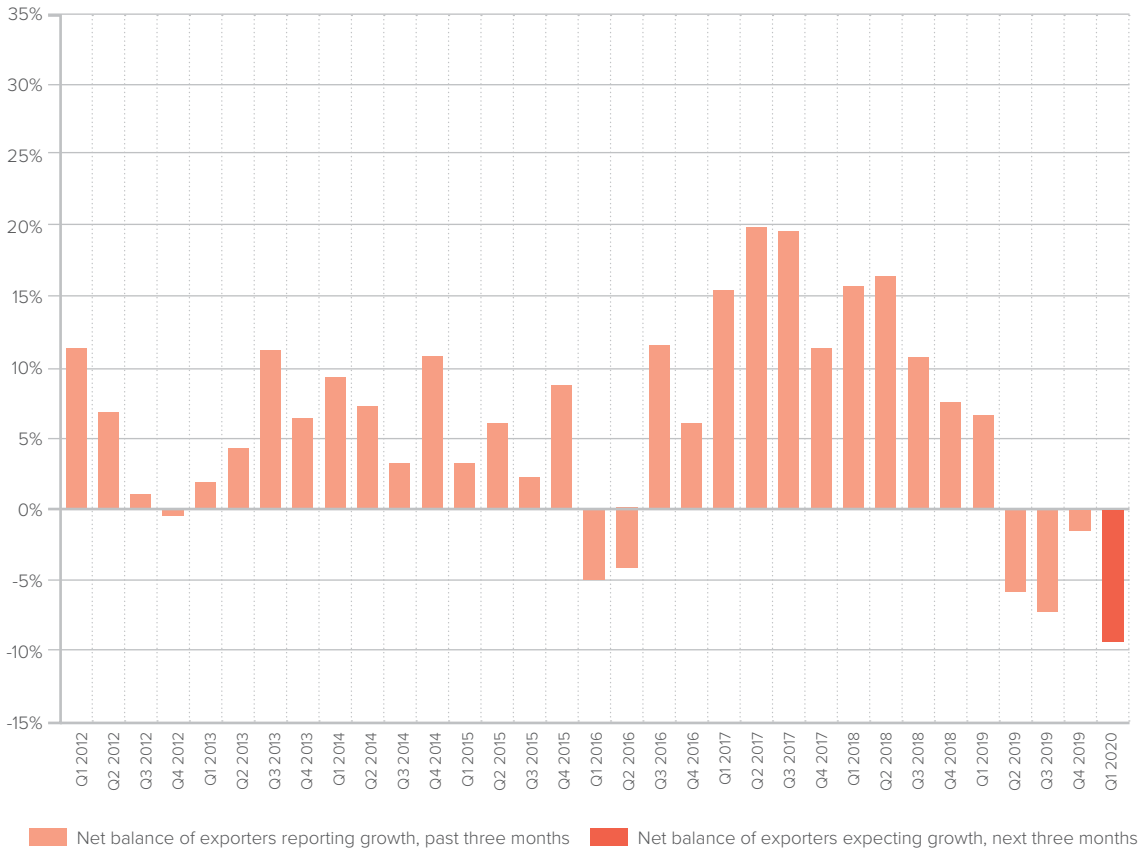
In Q4 2019, the proportion of small businesses reporting an increase in the value of their exports was lower than the proportion reporting a decrease for the third consecutive quarter. Although the net balance for export value growth rose by 5.5 percentage points compared to Q3 2019, at -1.6% this marked a year-on-year decline of 9.2 percentage points.

The net balance of firms expecting an increase in exports over the next quarter fell by 5.4 percentage points during Q4, to -9.5%. This is the lowest level on record, and is only the third time that the export growth expectations net balance has been negative.

After excluding some erratic goods, e.g. non-monetary gold bullion, that can distort trade data, the UK's total trade deficit in the three months to November 2019 was £1.1 billion. This meant the total trade deficit had

narrowed, compared to the previous three months, by £1.0 billion, primarily as a result of £2.3 billion growth in service exports which was only partially offset by increased services imports (+£0.6 billion) and an increased goods deficit (+£0.7 billion). The value of the pound strengthened against the euro and the dollar during the final quarter of 2019 which would typically be expected to boost imports and hold back exports. Meanwhile, the government's indication that they will seek a quick trade deal with the EU, to be completed before the end of 2020, may lead some to suspect that any initial deal will be limited in scope. Raising barriers to trade with the EU before any new trade deals are struck is likely to reduce the potential for export growth in the medium-term, once the transition period has ended.

Figure eight: Changes in value of exports – previous three months and expectations for coming three months net percentage balance – proportion reporting increase less proportion reporting decrease.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



COSTS AND INFLATION

Employment expenses rise

ACCOMMODATION & FOOD SERVICES BUSINESSES FACE LABOUR COST SQUEEZE

A net balance of 61.3% of small businesses reported an increase in operating costs during the past three months compared with the same period a year ago. Between Q3 and Q4 2019, the net balance rose by 1.5 percentage points, although it now stands 1.9 percentage points lower than in Q4 2018.

Labour costs continue to be the most frequently cited cause of rising costs for small businesses in the final quarter of 2019. The proportion of small businesses referring to labour as a source of cost pressure rose by 3.6 percentage points compared to Q3 2019, to stand at 43.5%. This is 0.8 percentage points higher than in Q4 2018. Rising wages, especially among some lower income workers, mean businesses in the accommodation & food services sector were

especially likely to be affected. While a net balance of 82.4% of businesses in the sector reported rising costs across all categories, two thirds (65.6%) of businesses reported labour costs as an issue in Q4. Notably, a high proportion of information and communication businesses (60.3%) also indicated that labour costs were rising, perhaps as strong growth in the industry has led to competition for skilled workers.

Compared to the final quarter of 2018, a much lower proportion of businesses have reported that fuel was driving costs higher. The net balance decreased by 11.4 percentage points compared to Q4 2018 as global oil prices have fed through to lower pump prices and fuel duty remained frozen at the last budget.

Figure nine: Small businesses reporting an increase in overall cost of operation over past three months, compared with the same period a year ago; net percentage balance.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.

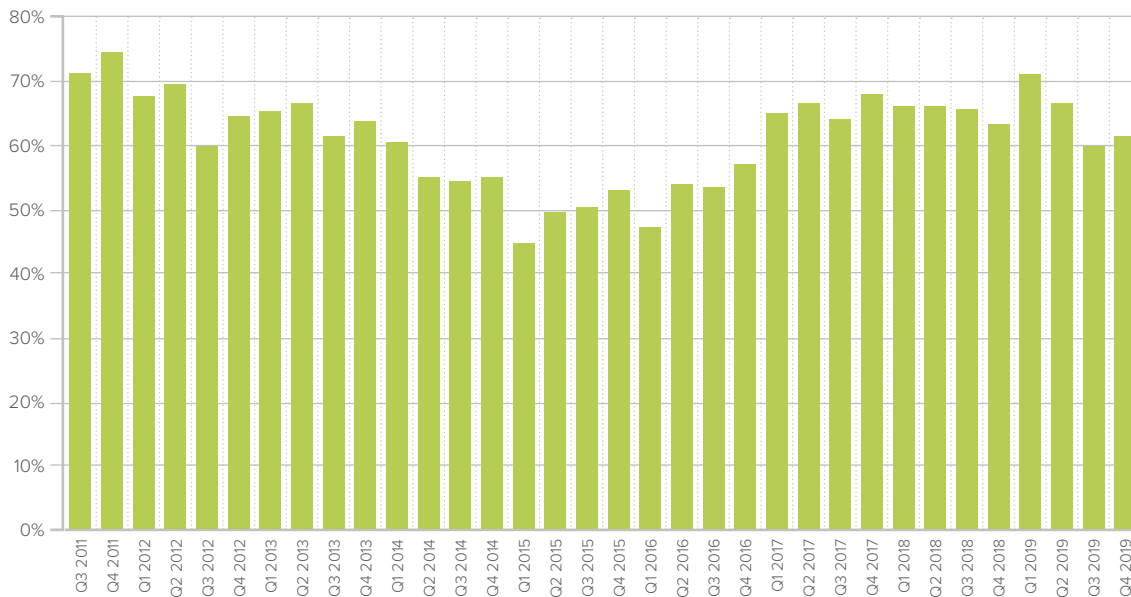
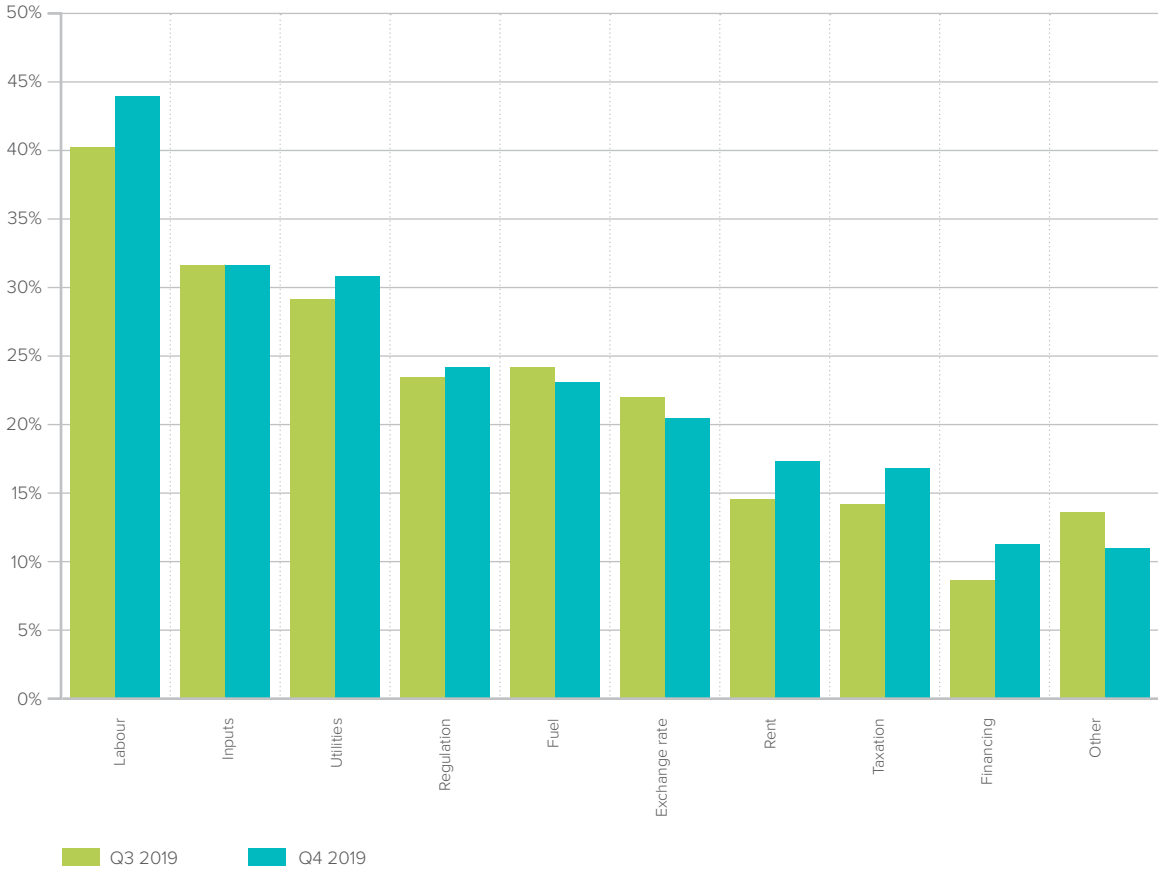


Figure 10: Main causes for changing business costs (firms may give multiple answers).
 Source: FSB - Verve 'Voice of Small Business' Panel Survey.



CAPACITY

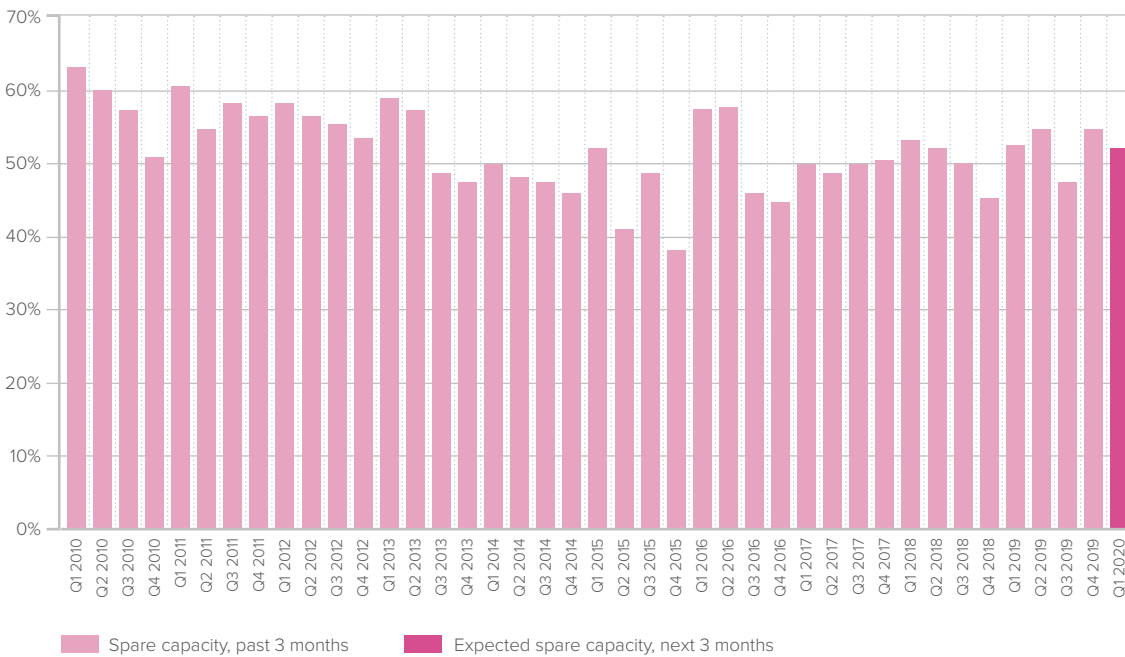
Fewer firms firing on all cylinders

EXPECTATION OF SPARE CAPACITY REACHES SEVEN-YEAR HIGH

After a dip in Q3 2019, the net balance of small businesses reporting that they were operating below capacity rose by 71 percentage points in Q4, to stand at 54.4%. The proportion of firms operating below capacity rose to 63.2%, while the proportion operating above capacity fell to 8.8%. Year-on-year, the net balance of businesses operating with spare capacity rose by 9.3 percentage points. The spare capacity net balance was highest in Wales and the East Midlands, at 68.8% and 62.5% respectively.

The net balance of small businesses that expect to have spare capacity over the next three months rose by 9.2 percentage points in the final quarter of the year to stand at 51.7%. The expectations net balance was last recorded above this level in Q4 2012 when it reached 54.3%. This aligns with other survey data that suggests weaker output across a number of sectors. Notably, a net balance of 90.3% of accommodation & food services firms expect to have spare capacity in the coming three months.

Figure 11: Net percentage balance of businesses running below capacity: proportion below capacity less proportion above capacity.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



EMPLOYMENT

Hiring intentions cool

NEGATIVE EMPLOYMENT NET BALANCE HIGHLIGHTS LABOUR MARKET SLACK

Over the last three months, a higher proportion of small businesses (12.5%) reported that their workforce has decreased in size, compared to those who reported an increase (11.0%). The net balance of -1.5% marks a quarterly decline of 3.4 percentage points compared to Q3 2019. Year-on-year the decline of 5.4 percentage points in the net balance is more pronounced. A net balance of -16.0% in Wales suggests that small businesses may be more actively scaling back their staffing levels as almost one-in-four (24.0%) indicated a reduction in staff numbers during the final quarter of 2019.

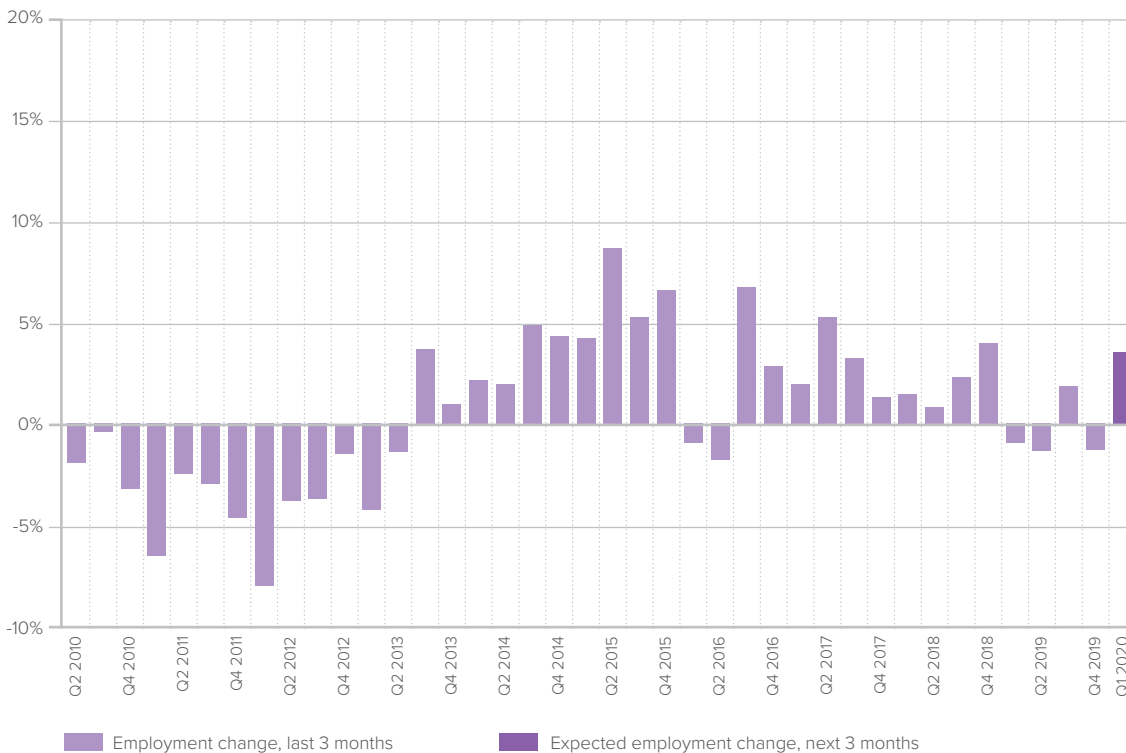
By contrast, more small businesses expect that they will increase rather than decrease their headcount over the next three months. However, the expectations net balance of 3.5% still marks a 1.6 percentage point decline compared to the

previous quarter's net balance, which stood at 5.1%. The information and communication sector had the highest expectation for hiring over the next three months, with a net balance of 15.1%.

The latest national statistics indicate that the employment rate hit a new record level of 76.2% in the three months to October. The unemployment rate also remained at the historically low level of 3.8% over the same period, suggesting that the pool of available labour is shrinking. This is likely to be limiting the ability of small businesses to find appropriate staff even when they are willing to expand. However, the number of vacancies stood at 805,000 in the three months to December – 49,000 lower than the number at the same point in 2018. The fall in the number of vacancies further highlights an increasingly cautious approach to hiring by small businesses.

Figure 12: Net percentage balance change in number of people employed – proportion reporting increase less proportion reporting decrease.

Source: FSB - Verve 'Voice of Small Business' Panel Survey.

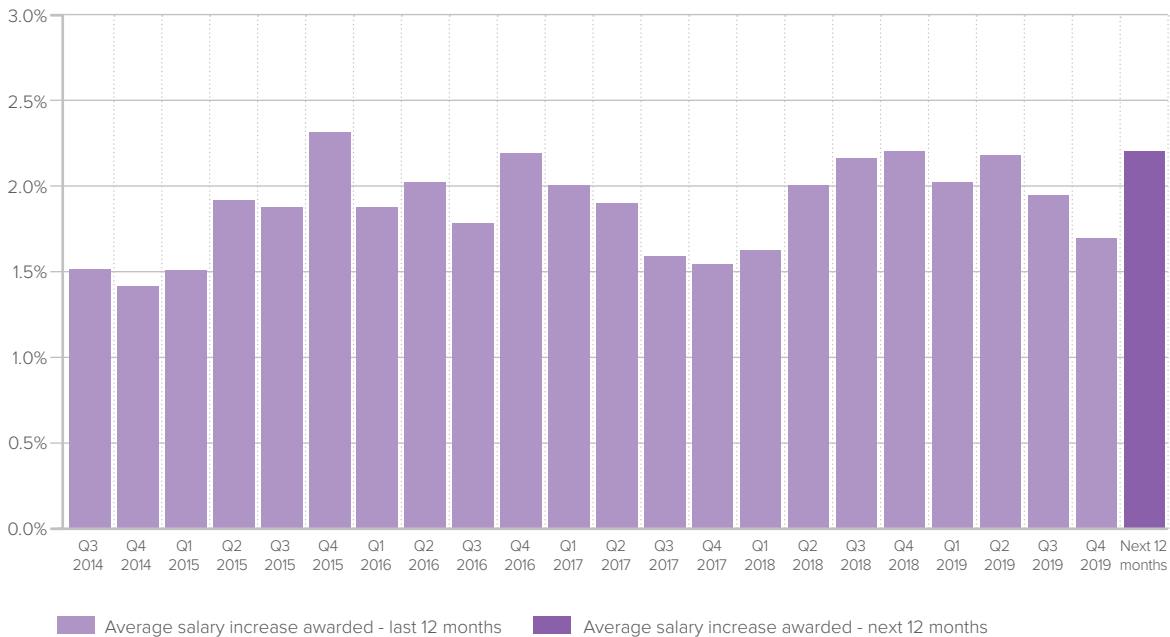


SMALL BUSINESS WAGE GROWTH FALLS BACK

In Q4 2019 the average annual rate of wage growth among small businesses fell by 0.3 percentage points to 1.7%, this is the lowest rate of growth since Q1 2018. Year-on-year, the rate of wage growth has fallen back by 0.5 percentage points from 2.2%. Small businesses in London saw the weakest annual wage increases, at just 0.4%. By sector, the largest increases were recorded in both the information & communication and manufacturing sectors, where wages rose by an average of 2.6% over the last 12 months.

The latest ONS data show that in the three months to November, average earnings (including bonuses) grew by 3.2% year-on-year – 0.5 percentage points below the rate recorded in the three months to September. The slowdown in earnings growth as well as the increase in vacancies suggests an element of slack is emerging in the labour market. Despite this, small businesses expect wage growth to accelerate to 2.2% over the next 12 months. This is the highest rate of growth since the same period last year when expected wage increases reached 2.3%.

Figure 13: Average salary increase awarded, this quarter versus a year before.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



GROWTH ASPIRATIONS AND CHALLENGES

One in ten plan to shut up shop

GROWTH ASPIRATIONS SLIP BACK

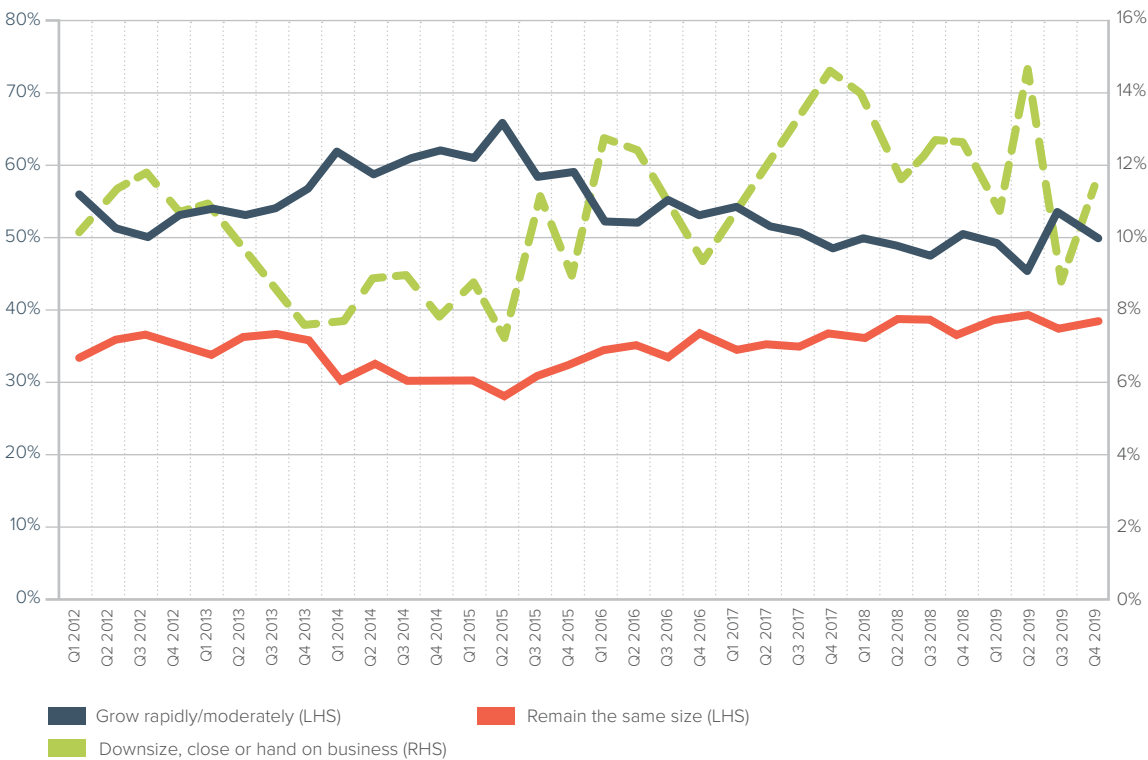
The proportion of small businesses that aspire to grow over the course of the next 12 months fell by 3.6 percentage points between Q3 and Q4 2019 to 50.1%. The falling level of business confidence across the UK seems to have driven more business owners to consider scaling back their operations over the coming year. The share of small firms planning on downsizing, closing or handing on their business increased by 2.8 percentage points, to 11.5%. This figure is, however, down by 1.3 percentage points compared to Q4 2018.

Businesses in Wales (22.5%) and the East of England (18.7%) are the most likely to scale back over the coming year. Aspirations to grow were greatest in the North West, London, the East Midlands and the

South East, where the proportion of small businesses expecting to grow was 60%, 54.7%, 54.6% and 54.5% respectively. In line with other indicators, information and communications firms were much more likely than average to be optimistic. Over the coming year, 70.5% of these businesses expected to grow.

The proportion of small businesses that aspire to grow is broadly in line with the average during 2017 and 2018 (50.3%), although the heightened political and economic uncertainty that characterised 2019 led to this measure being much more volatile. With the most extreme outcomes for Brexit now seemingly off the table, small businesses should be able to plan more confidently in the quarters to come.

Figure 14: Growth aspirations for next 12 months.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



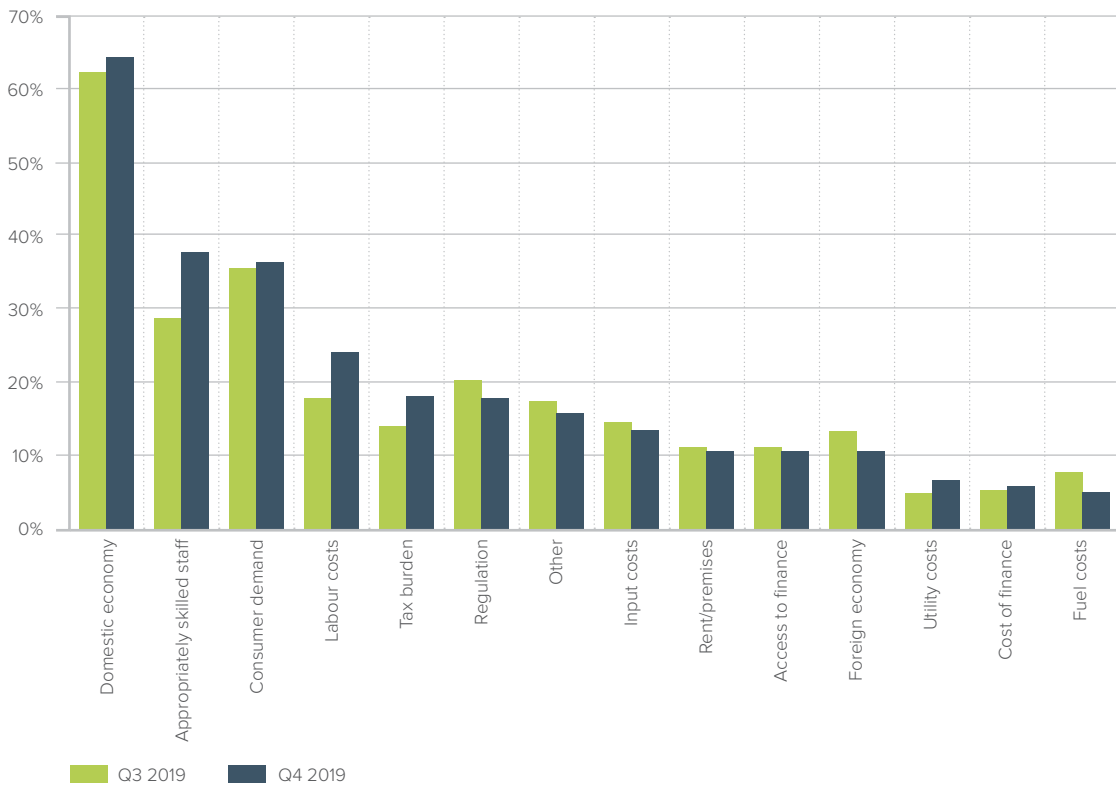
CONCERN OVER FINDING APPROPRIATELY SKILLED STAFF HITS RECORD HIGH

The domestic economy remains the dominant concern among small businesses in the UK when it comes to growth aspirations. Following a 2.0 percentage point increase compared to the previous quarter, the proportion of firms citing the domestic economy as a barrier to growth was 64.4% in Q4 2019. The next most widespread cause for concern was finding appropriately skilled staff. A quarterly increase of 8.7 percentage points brought the share of businesses finding the recruitment of the right staff a barrier to growth to 37.2% - the highest level since this category was first included in the survey in Q4 2013. Concern over this issue is mirrored in rising labour costs, which 24.1% of businesses felt was a barrier to growth, up by 6.4 percentage points compared to the previous quarter.

With the unemployment rate dropping over recent years, competition for skilled staff has driven up wages across industries. Information and communication businesses were the most likely to face concerns over both appropriately skilled staff and labour costs, with 57.8% and 42.4% of firms flagging these issues respectively.

The international economy was considered less of a barrier in Q4 2019 - the proportion of firms concerned about non-domestic economic issues fell by 3.3 percentage points, to 9.8% - the lowest value on record. Lower global oil prices and a stronger pound seem to have reduced the burden of fuel costs on small businesses, and the proportion of businesses citing these as a barrier to growth fell by 2.6 percentage points over the quarter, to stand at just 4.7%.

Figure 15: Potential barriers to achieving growth aspirations – multiple answers possible. Source: FSB - Verve 'Voice of Small Business' Panel Survey.



CREDIT

Borrowing rates fall but concerns about affordability rise

HIGHER PROPORTION OF BUSINESSES RECEIVE LOW INTEREST RATE OFFERS

Figure 16: Credit applications and interest rates offered.
 Source: FSB - Verve 'Voice of Small Business' Panel Survey. Respondents were able to give multiple answers to this question.



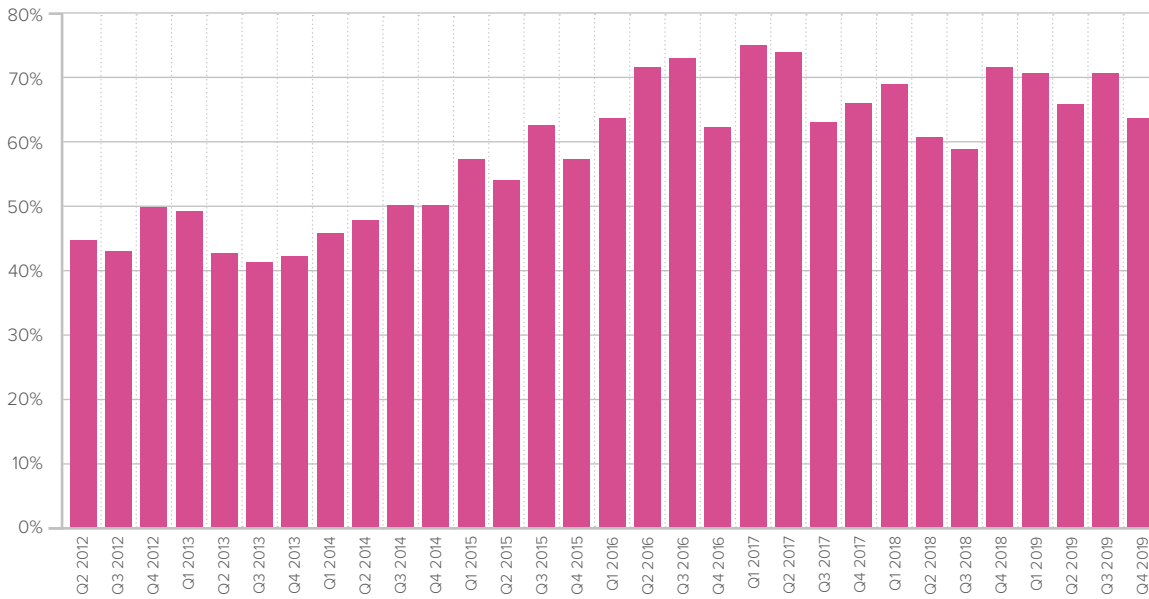
In the final quarter of 2019, the proportion of small businesses that applied for credit increased marginally, by 0.1 percentage points. The proportion of applications that were successful declined by 6.9 percentage points compared to Q3 and was down by

7.5 percentage points on Q4 2018, at 63.3%. This was in large part due to a higher proportion of businesses that were still awaiting a decision, which rose by 4.1 percentage points compared to Q3 to stand at 10.5%.

For successful applicants, the proportion that were offered an interest rate of less than 4% rose by 6.7 percentage points, to 40.8% This is a year-on-year increase of 14.8 percentage points, from 26.0% in Q4

2018. At the other end of the scale the proportion of businesses receiving offers of credit at interest rates over 11% fell by 4.9 percentage points from Q3 2019 to 8.5%.

Figure 17: Proportion of small businesses successful in their credit applications in the past three months.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



MORE SMALL BUSINESSES SEE CREDIT AS UNAFFORDABLE

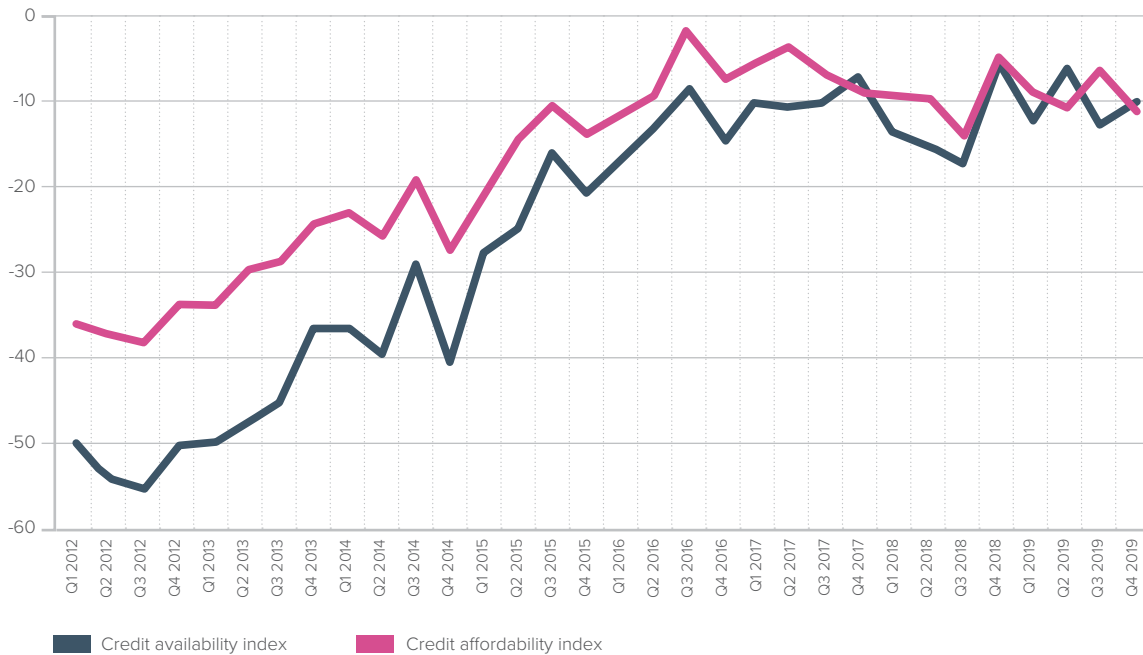
The credit availability index rose by 2.2 points to -10.5 in Q4 2019. However, this is down by 5.5 points on the same period a year earlier. The -5.0 recorded in Q4 2018 was the highest credit availability index score since records began in 2012. Despite the increase in firms being offered lower rates, the credit affordability index fell by 4.6 points compared to Q3, to stand at -11.3, as more businesses reconsider credit to be very unaffordable.

The Bank of England's main interest rate has been held at 0.75% since August 2018. While historically very low, the decision by the Federal Reserve in the US and the European Central Bank to cut their policy rates during 2019 has reignited the debate over whether, in the midst of slowing economic growth,

the Bank's Monetary Policy Committee should vote to reduce interest rates in the UK too.

Some lenders may have found their own borrowing has become cheaper as the prospect of rate rises in the short-term has diminished. A higher proportion of small firms that were successful in their credit applications were offered low rates in Q4. This suggests that lenders could be cutting rates to win business from the most credit-worthy borrowers. However, an annual decline in both the credit affordability and availability indices suggests that lenders may have decided that, in general, lending to small firms is relatively risky while the economy is slowing, making them more restrictive in their lending.

Figure 18: Indices of credit affordability/availability perceptions over time, a weighted net balance of those with negative responses subtracted from those with positive responses.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



INVESTMENT AND PRODUCTIVITY

Uncertainty drags on expansion

SMALL BUSINESSES CONTINUE TO HOLD BACK INVESTMENT

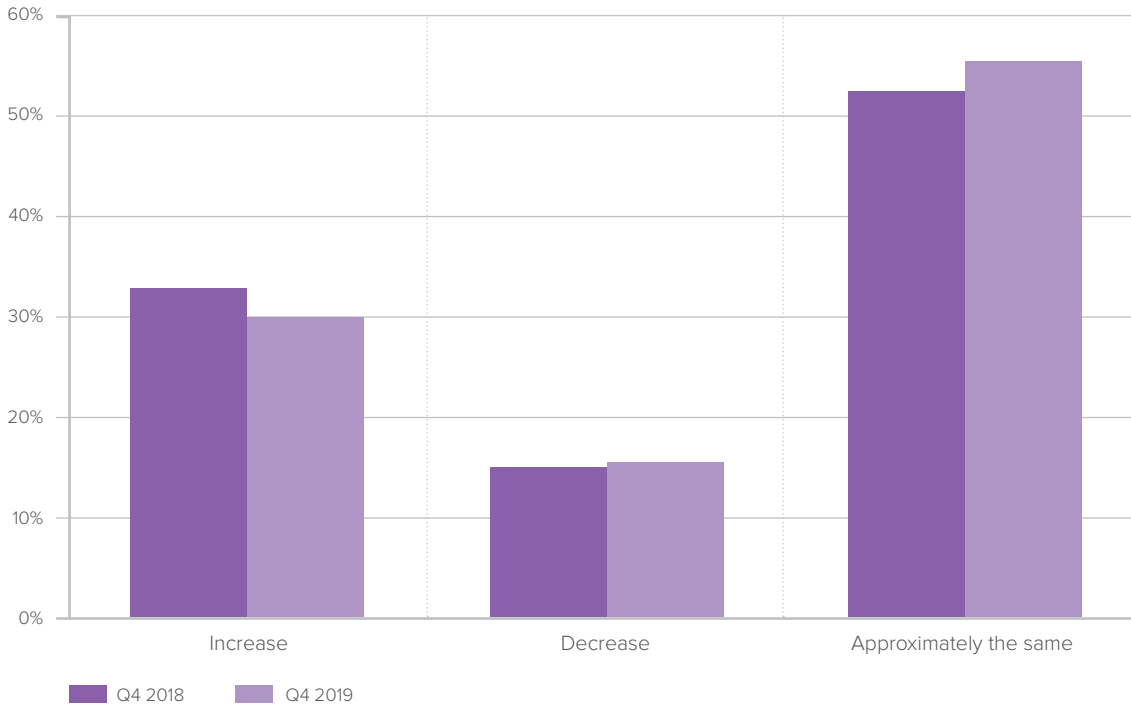
The share of small businesses expecting to increase capital investment over the next quarter rose by 3.4 percentage points compared to the previous quarter to stand at 29.7% in Q4 2019. This still represents a decline of 3.0 percentage points year-on-year as a higher proportion of businesses chose to hold their investment steady compared to last year.

Official statistics indicate that business investment fell every quarter throughout 2018. Although investment did pick up in Q1 2019, this flattened off again by Q3. Indeed, total business investment over the four

quarters to September 2019 was down around 2% on the peak recorded in Q2 2018. The decision to invest carries risk, and as future government policy becomes clearer then this risk is reduced. The newly emerging clarity over Brexit and the reduction in political uncertainty delivered by the general election result may have helped some small businesses to finalise investment decisions. The proportion of businesses holding investment steady fell by 4.7 percentage points compared to Q3.

Figure 19: Percentage of small businesses expecting to increase and decrease capital investment over next quarter, compared with 12 months ago.

Source: FSB - Verve 'Voice of Small Business' Panel Survey.



METHODOLOGY

This report is based on the November/December 2019 research survey of FSB members carried out by Verve. 5,988 panel members (all Big Voice members at time of survey) were invited to take part in an online survey as well as through an open link shared with FSB members. Reminders were sent to all non-respondents. 1,049 responses were received, a response rate of 11% for the panel. The data are weighted by regional gross value added to match the profile of small businesses across the UK. The survey was undertaken between 25 November and 9 December 2019.

SUMMARY DATA TABLE

	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019
Small Business Index	6	12.9	-1.7	-9.9	-5.0	-8.8	-8.1	-21.6
Employment - previous three months	1.6%	0.8%	2.3%	3.9%	-1.0%	-1.5%	1.9%	-1.5%
Employment - coming three months	8.7%	8.2%	7.4%	5.1%	7.0%	10.2%	5.1%	3.5%
Exports - previous three months	15.8%	16.5%	10.7%	7.6%	6.8%	-5.8%	-7.1%	-1.6%
Exports - coming three months	18.8%	16.0%	17.8%	0.2%	-1.6%	11.4%	-4.1%	-9.5%
Credit availability - rated good or very good	24.1%	21.9%	24.1%	30.2%	28.5%	28.9%	25.7%	27.5%
Credit availability - rated poor or very poor	39.3%	40.0%	42.5%	34.4%	39.0%	33.7%	39.4%	34.7%
Credit affordability - rated good or very good	25.3%	25.4%	23.7%	32.2%	27.9%	27.3%	28.1%	28.1%
Credit affordability - rated poor or very poor	39.2%	35.3%	41.7%	36.1%	37.9%	43.2%	33.8%	39.9%

The Small Business Index weights strong responses (much improved or much deteriorated conditions) double and subtracts the weighted proportion of firms reporting deterioration in business prospects over the coming three months from the weighted proportion expecting an improvement.

The Employment and Revenue indicators are net percentage balances, with the proportion of firms reporting a decrease subtracted from the proportion reporting an increase.

Responses are also weighted according to regional gross value added.

Q4

© Federation of Small Businesses

fsb.org.uk

 [federationofsmallbusinesses](https://www.facebook.com/federationofsmallbusinesses)

 [@fsb_policy](https://twitter.com/fsb_policy)

If you require this document in an alternative format please email:
accessability@fsb.org.uk

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior permission of FSB. While every effort has been made to ensure the accuracy of the facts and data contained in this publication, no responsibility can be accepted by FSB for errors or omissions or their consequences. Articles that appear in the report are written in general terms only. They are not intended to be a comprehensive statement of the issues raised and should not be relied upon for any specific purposes. Readers should seek appropriate professional advice regarding the application to their specific circumstances of the issues raised in any article.

This report can be downloaded from the FSB website at www.fsb.org.uk

fsb⁰⁸
Experts in Business